

# LEGISLATIVE AUDIT COMMISSION



Review of  
Department of Revenue  
Two Years Ended June 30, 2003

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**REVIEW: 4210**  
**ILLINOIS DEPARTMENT OF REVENUE**  
**TWO YEARS ENDED JUNE 30, 2003**

**FINDINGS/RECOMMENDATIONS - 10**  
**UNDER STUDY -1**  
**ACCEPTED - 4**  
**IMPLEMENTED - 5**  
**REPEATED RECOMMENDATIONS - 2**

**PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 9**

This review summarizes an audit of the Illinois Department of Revenue for the two years ended June 30, 2003, filed with the Legislative Audit Commission April 27, 2004. The auditors conducted a compliance audit in accordance with Government Auditing Standards and State law. In addition, they examined the financial statements and indicated they are fairly presented. The Illinois Gaming Board and the Illinois Racing Board, both divisions of the Illinois Department of Revenue, are addressed in separate audit reports.

The Department of Revenue is empowered to administer, collect, enforce and determine the distribution of the taxes imposed by the State's major tax acts. The Department collects approximately 75% of the receipts deposited into the General Revenue Fund. A significant portion of the Department's total effort relates to the collection of the Retailers' Occupation Tax and related taxes, income taxes, and personal property replacement taxes. The revenue collected from these sources approximates 82% of taxes collected by the Department. The remaining 18% of the Department's revenue is derived from the collection of more than 25 other taxes.

In addition to collecting State taxes, the Department collects some taxes on behalf of local governments, administers the Circuit Breaker and Pharmaceutical Assistance Programs, and supervises the property tax system.

Mr. Glen Bower was the Director of the Department during most of the audit period. The current Director, Brian Hamer, was appointed in February 2003. Prior to his appointment, Director Hamer had no previous association with the Department of Revenue.

The average number of employees at June 30 was:

	<b>FY03</b>	<b>FY02</b>	<b>FY01</b>
Government Services	142	174	180
Tax Enforcement	584	661	648
Tax Operations	1,306	1,504	1,569
<b>TOTAL</b>	<b>2,032</b>	<b>2,339</b>	<b>2,397</b>

**Expenditures From Appropriations**

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The General Assembly appropriated \$893,474,891 to the Department in FY03. The Department had expenditures of \$711,072,826 in FY03 compared to expenditures in excess of \$924 million in FY02 and almost \$1.1 billion in FY01. The decrease was due primarily to the transfer of the Senior Care program to the Department of Public Aid (\$98 million); the elimination of the photo processing sales tax (\$57 million); a downturn in gaming (\$17 million); and reduction in scope and size of grants from the Illinois Affordable Housing Trust Fund (\$16 million) and the Federal Home Investment Trust Fund (\$7 million). Appendix A summarizes the appropriations and expenditures for the period under review.

The Department's operations are financed primarily from the General Revenue Fund, the Motor Fuel Tax Fund, State Gaming, and the Personal Property Tax Replacement Fund.

### **Cash Receipts**

Appendix B summarizes cash receipts of the Department during each of the two years under review. Cash receipts increased from \$24.03 billion in FY02 to \$24.3 billion in FY03, an increase of 1%. Significant portions of the receipts relate to the collection of the income tax (40.1% of all revenues) and the Retailers' Occupation Tax and related taxes (40% of all revenues). The remaining 19.9% of the Department's revenue is derived from numerous other taxes which the Department is empowered to collect.

Cash receipts increased \$276 million in FY03 compared to FY02. Large increases were noted in the cigarette tax (\$179 million); various sales taxes (\$95 million); public utility taxes (\$42 million); and riverboat gambling (\$121 million). However income tax and fee collections decreased \$164 million.

### **Taxes Receivable Balances**

Appendix C is a summary of taxes receivable balances. Total taxes receivable decreased from \$1,957,896,000 as of June 30, 2002 to \$1,757,167,000 at June 30, 2003. These taxes are due from individuals, corporations, and businesses. In FY03, approximately \$687 million of \$1.9 billion was considered uncollectible.

### **Capital Assets**

Appendix D is a summary of capital assets for FY03 and FY02. Total equipment decreased from \$26,360,000 as of July 1, 2002 to \$23,633,000 as of June 30, 2003.

### **Accountants' Findings and Recommendations**

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Condensed below are the ten findings and recommendations presented in the audit report. There were two repeated recommendations. Updated responses to the recommendations are classified based on information provided by Director Brian Hamer in a memo dated October 20, 2004.

### **Under Study**

#### **3. Develop a systemic program to identify and notify W-3 non-filers.**

**Findings:** During a review of the Department's internal audit reports, the auditors noted the Department receives Employer's Quarterly Illinois Withholding Tax Returns (941) and Illinois Annual Withholding Income Tax Returns (W-3) from employers. However, the Department does not reconcile the two returns to determine if there were any non-filers if a W-3 is not received.

**Updated Response:** Under Study. The Department initiated a pilot project to identify and notify W-3 non-filers. Effective August 2, 2004, we mailed notices to 403 randomly selected W-3 non-filers and asked them to either 1) file their 2002 IL-W-3 within 30 days or 2) certify that their business was not required to pay Illinois withholding taxes for the period in question. The Account Management Division (AMD) of Taxpayer Services Administration tracked responses to these notices through the end of September. They received 197 written responses and only three phone inquiries. Of the 197 responses; 10 had W-3's post to the system during the project, 156 furnished a 2002 W-3 that balanced with previously submitted 941's already on the system; AMD contacted these taxpayers and requested amended returns. As of October 5, 2004, this project resulted in no additional revenues. Based on an analysis of available data, we will determine our next course of action by December 1, 2004 and proceed accordingly.

### **Accepted or Implemented**

#### **1. Ensure completion of accurate GAAP packages and implementation of new accounting pronouncements in preparing financial statements.**

**Findings:** The Department submitted inaccurate accounting reports to the Office of the State Comptroller. The Department filed its GAAP package forms with the Comptroller. However, the Department did not reflect all the required adjustments to comply with GASB

**Accepted or Implemented - continued**

pronouncements in the financial statements and GAAP forms submitted. \$142.6 million in deferred revenue adjustments was not posted.

**Response:** Accepted. The noted omission resulted from a new FY03 Comptrollers' Office reporting procedure requiring submission of entity-wide adjustments with the GAAP packages rather than after all GAAP packages are submitted as was done in FY02. In fact, the Comptroller's Office GAAP package checklist was checked "not applicable" on form SCO-546. As discussed in the exit conference, we would have caught this omission during our review process had the auditor not found it first. This omission should not recur.

**2. Perform additional information system reconciliations and cross-matches and take appropriate action to ensure collection of tax revenues owed to the State.**

**Findings:** The Department has not implemented various automated reconciliation and cross-match procedures to ensure that information included in certain automated systems reconciles to other Department information system records or data available externally.

The auditors noted the following:

- The Department is not entering necessary data to allow it to accurately verify certain tax information that is received from individual taxpayers or businesses. This practice prohibits the Department from performing an automated cross-match or reconciliation to other Department information system records or available external sources. This limits the Department's ability to monitor individuals or businesses that may not have submitted the proper tax liability.
- The Department has not performed a reconciliation or cross-match for individuals who only report wages on the individual's tax return or have not filed a tax return, but have received wages from an employer.
- The Department has different tax systems for Withholding Income Tax and Individual Income Tax. Additional reconciliation and cross-matching between the two systems is required in order to realize associated compliance benefits.

**Updated Response:** Accepted. While the Department has previously discussed various manual and systemic work-around approaches to addressing the inability to perform the suggested reconciliations, we recently recognized that the only practical approach is to upgrade and re-write our major tax systems.

We are currently developing a FY06 budget request to fund the first stage of this process. If the Department is successful in securing funding, system design work could begin early in FY06.

At this point in time, it is impossible to predict when this finding would be resolved.

**4. Comply with the Illinois Sports Facilities Authority Act and ensure certifications are submitted to the Office of the State Comptroller in a timely manner.**

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**Findings:** The Department did not process monthly certification of amounts paid to or on behalf of the Illinois Sports Facilities Authority timely. The auditors noted seven of 24 monthly certifications were submitted to the Comptroller one to 15 days late.

**Updated Response:** Implemented. Operating procedures now require the Miscellaneous Taxes Division to complete their closeout by the 10<sup>th</sup> of every month, ensuring the timely allocation of funds to the Illinois Sports Facilities Authority. Any returns that have problems will be considered reconciling items and the allocations will be made in subsequent months when the problems have been corrected. This finding should not recur.

### **5. Comply with the Vehicle Policy Manual to ensure proper recording of vehicle information.**

**Findings:** The Department reported odometer readings inaccurately. The auditors noted the following inconsistencies in the mileage used by employees using State assigned automobiles:

- Mileage on the monthly cost reports did not agree to the Department's Owned Cost per mile report.
- On certain cost reports, the ending odometer reading of the previous month's cost report did not equal the beginning odometer reading per the current month report.
- Odometer readings changed, but no mileage detail was reported.
- Zero mileage balances were reported when there was activity.

**Updated Response:** Implemented. The Department implemented a new policy effective April 1, 2004, requiring that all employees using State vehicles 1) document the purpose of all mileage accrued on the vehicle and 2) submit reports to our vehicle coordinator for collection and review on a monthly basis.

### **6. Provide the Buyer Demand letter as specified by statute. (Repeated 2001)**

**Findings:** The Department did not provide timely written "buyer demand letter" notices to the purchaser or transferee of business assets. The purpose of the letter is to notify the purchaser/transferee of the actual amount of all taxes, penalties and interest due from the previous owner, and whether additional amounts may become due. The auditors noted that two of 15 Buyer Demand letters were provided after the required 60-day due date.

**Updated Response:** Implemented. On March 19, 2004, the Collections Bureau Manager issued a written reminder to the supervisor over Bulk Sales. The reminder

**Accepted or Implemented - continued**

stressed that Buyer Demand letters must be issued within 60 days after the issue of a Bulk Sales Stop Order.

- 7. Formally assign contingency planning responsibilities to ensure the performance of adequate contingency planning in an effort to minimize overall impact due to a disaster situation. Make contingency planning a continuous process to ensure that contingency plans are adequate and tested to provide the capability to recover critical operations and systems within the required timeframe.**

**Assess current operation load capacity to ensure the computer room environment is adequate for current computer processing and projected growth. Continue efforts to repair defective equipment and ensure adequate maintenance is performed to increase the lifetime and reliability of equipment. (Repeated-1999)**

**Findings:** The Department has not ensured adequate contingency planning for recovery in the event a disaster would render its computer operations inoperable.

Each year the Department processes approximately 5.6 million individual and 378,000 corporate income tax returns. The Department created a disaster contingency plan, implemented in June 2000, consisting of 22 individual plans collectively representing all of the major business operational and functional areas and a senior staff response plan.

The auditors identified several deficiencies in the Department's disaster contingency planning efforts including:

- The functional and response plans did not have an effective date to show when the Plan was last modified and did not always contain specific detailed procedures or include a reference to the procedures.
- A limited test was performed in August 2002 which consisted of taking the telecommunications system offline and bringing it back up. A comprehensive recovery test had not been performed.
- The Department has not adhered to a schedule of planned recovery tests established for 2000 to 2011.
- Disaster Contingency Coordinator responsibilities had not been formally assigned.
- An analysis of current capacity availability was not performed to ensure that the current computer environment could adequately support the additional load brought on by the relocation of an additional mainframe computer into the Department's computer room.
- Personnel performing contingency planning duties were unaware that dual transformers, power source switches and chillers were not all fully operational.
- The Department does not have a guaranteed and comprehensively tested alternate recovery site.

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**Response:** DOR recognizes the need to perform adequate contingency planning as demonstrated over the course of several years. A great deal of effort has gone into developing and maintaining plans for each operational area within the Department. Testing of critical components has been conducted and will continue to be conducted within current resource constraints. This is a continuous process for the Department as all plans are reviewed and updated on an annual basis. A test of the recovery of the Department's data center at the CMS site is scheduled for the week of January 8, 2005. It is a multi-day process.

Contingency planning responsibilities have been formally assigned for some time. The Department is interpreting this recommendation as one for additional resources to be allocated to this function. The Department will perform an evaluation of the risks associated with any perceived deficiency in this area as compared to other resource priorities and make a determination in these regards.

As a procedural step in installing any new equipment in the data center (including tape, disk, or mainframe components), we work with vendors and the Secretary of State (SOS) electricians to perform a systems assurance to verify that the computer room environment is within tolerances for load capacities at all times. As an example, the vendor (IBM), our Willard Ice Building (WIB) building engineer, and SOS electricians were contacted to evaluate capacity to handle the additional equipment. In an effort to better comply with this recommendation, the Department will implement documentation of these reviews to formalize the process. In addition, the Department will continue its efforts to adequately maintain and repair defective equipment per the recommendation.

### **8. Continue progress in the development of an inventory system that can track returns and incoming correspondence from the time it is received by the Department until it is set up in the collection process or sent to Files, and provide management with adequate reports.**

**Findings:** The Department does not have an efficient electronic system to track cases/taxpayer correspondence that the Department receives and maintains. The auditors noted that the Individual Income Tax Division utilized six different inventory systems to track cases/taxpayer correspondences. Tracking of cases/inventory is not effective due to the following:

- True aging of accounts is difficult to determine when inventory is closed on one system and set-up on another system. The aging starts over every time the account is moved. Also, employees must re-enter all information in the new system.
- The Department must look in several inventory systems to find a case file or taxpayer correspondence.

### **Accepted or Implemented - concluded**

- Information services must maintain several different systems.



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- Employees must be trained on different systems and given access to several different systems.
- Management must review several different inventory reports.

Department personnel indicated that a Tax Response Monitoring system has been selected to be upgraded to take over all of the functions of the other five inventory systems.

**Updated Response:** Accepted. The Department continues to make steady progress toward implementation of a single inventory system, Taxpayer Response Monitoring System (TRM). At this point in time, we cannot estimate a target completion date for implementation of a single IIT inventory system. As indicated in the text of this finding, the Individual Processing Division is already using TRM. They plan to eliminate their use of other inventory systems by the end of 2004. The Stop Bill Processing system has already been eliminated. The Taxpayer Services Administration is “next in line” for TRM implementation. Once accomplished, remaining IIT inventory systems will be targeted for elimination.

### **9. Examine available I-Track reports and implement procedures to ensure adequate monitoring and reconciliation of the information contained in these reports. Additionally, the I-Track report indicating accounts over 1,100 days should be reviewed by upper management.**

**Findings:** The Department does not have proper controls to review the status of accounts that are maintained on the I-Track system. The I-Track system maintains the location within the Department of an account and the individual the account is assigned to. During a review, the auditors found 3,996 accounts on the report were over 400 days old. Ages of these accounts ranged from 427 days to 8,557 days old.

If an account is on the I-Track System, the Individual Income Tax (IIT) system will not allow the account to progress into the Illinois Collections System and through the collection process. In addition, without reviewing the I-Track reports, it does not appear that the Department is reconciling actual physical case files to the I-Track system or reconciling the I-Track system to area control databases or inventory systems.

**Updated Response:** Implemented. As requested by our Chief of Staff in October 2003, operational managers whose areas utilize I-track have incorporated reconciliation guidelines into written procedures and are including the status of aged inventory in their monthly reports. Managers provided copies of reconciliation procedures to our internal auditors (now IOIA auditors).

It should be noted that there are legitimate, acceptable reasons why tracks in certain locations age (e.g. pending settlement of a court case, audit, or BCI criminal case). Reconciliation is vital to ensuring the integrity of our process, and monitoring of aged tracks is necessary for control purposes. However, it is more important to note the

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reasons for aged tracks (and the validity of these reasons) as opposed to focusing solely on the number of aged tracks. In a recent review of our aged tracks, we determined that at least 92% of tracks aged over 1,100 days are associated with ongoing legal disputes. In addition, the majority of tracks between 400 and 1,100 days old belong to a pool of accounts either under or awaiting audit. In October 2003, our Chief of Staff issued a written directive to operational managers whose areas utilize I-Track instructing them to: 1) incorporate their reconciliation guidelines into written procedures, and 2) include the status of aged inventory in their monthly reports. After reviewing these reports, the Chief of Staff may choose to request additional details.

### **10. Modify the Withholding Income Tax System to allow for accounts that have credits to offset the liabilities to reduce the need for additional resources.**

**Findings:** The Department's Withholding Income Tax (WIT) system is not efficient in regard to liabilities that can be offset by credits. The auditors noted that the WIT system allows for individual accounts to be sent to the collection system even though the individual accounts have outstanding credits on the account. These credits could be used toward the individual's liabilities.

**Updated Response:** Accepted. The Department has initiated corrective action via Service Request 03-0769. Completion of the service request may be delayed due to funding.

## **Emergency Purchases**

The Illinois Purchasing Act (30 ILCS 505/1) states that "the principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services or to insure the integrity of State records. The Chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

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During the audit period, the Department filed three affidavits for emergency purchases totaling \$444,770.00 as follows:

- \$370,822.00 for a fire alarm system at the Willard Ice Building;
- \$49,200.00 to extend a contract for cigarette tax stamps; and
- \$24,748.00 for a financial review related to the Emerald Casino.

### **Headquarters Designations**

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time.

In June of 2003, the Department indicated it had 324 employees assigned to a location other than official headquarters.